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West sets pace as kings of venture capital

Alberta, B.C. effectively deliver commercial value

By Monte Stewart - Business Edge

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Alberta and B.C. bring companies to market faster than any other jurisdictions in North America, says a new University of British Columbia study on venture capital performance.

"It doesn't prove but it suggests we're quite efficient at converting (research and development projects) into commercial value," says UBC Sauder School of Business professor and study author Thomas Hellman.

Hellman notes the study's results challenge the notion that the Canadian venture capital market is significantly behind that of the U.S. On average, during the 1997-2004 period of the study, venture capitalists brought Alberta firms to market within 39 months after they were founded, while B.C. companies took 47 months to get to market.

Ontario ranked 10th in North America in average startup time, at 81 months. However, Canada's largest province placed third in North America in the number of companies (223) that achieved public marketization.

Stressing his group's findings are preliminary and data is limited, Hellman says Alberta and B.C. have brought companies to market sooner because they have been "very good" at capitalizing on the junior TSX Venture stock exchange, which poses fewer financial hurdles than large exchanges.

Considered the first of its kind, the study evaluated Canadian and U.S. companies based on when venture capitalists bowed out because of an initial public offering (IPO) or acquisition worth more than $1 million by a publicly traded firm. Such departures were classified as "exits."

It also compared 509 Canadian companies in major technology centres according to their "exit values" - their worth at the time venture capitalists departed because of IPOs or takeovers.

B.C. produced the best return per dollar spent on research and development (R&D) in North America, generating $494.24 for every $1,000 invested, while Alberta ranked third at $460.68. The two provinces even outperformed California and Massachusetts, which received the largest amounts of R&D investment. Ontario was eighth at $285.40.

"These findings reinforce our central themes that smaller venture capital markets may sometimes be the most efficient ones," Hellman writes in the study.
But Rick Nathan, president of the Canadian Venture Capital Association, which represents most private equity companies in Canada and has more than 1,000 members, says the study confirms the challenges faced by Canadian companies in arranging later-stage financing.

"What this often leads to is Canadian companies will sell their companies to the U.S., mainly because that is where most of the buyers are," says Nathan.

As a result, Canada is less likely to grow larger companies.

"If you're a VC investor, your main goal is to make money," says Nathan. "(Early marketization) is not a problem per se. If you're making policy in government, you would probably prefer to build large companies that are more sustainable for the long term."

Nathan, also the managing director of Toronto-based Goodmans Venture Group, part of Goodmans LLP that provides strategic legal and business advice to private-equity investment companies and entrepreneurs, says the large number of startups in Ontario is not surprising because Ontario is Canada's largest market. Ottawa, Toronto and London also have large amounts of software and telecommunications investors.

But Canada's relatively small number of biotech companies, which often require up to 10 years to gain regulatory approval for R&D projects, reflects the lack of later-stage capital.

Gary McPherson, executive director of the Canadian Centre for Social Entrepreneurship (CCSE) based at the University of Alberta, says Alberta's entrepreneurial risk-taking spirit likely plays a key role in getting companies to market more quickly than other provinces.

The CCSE aims to bring together private, public and voluntary sector interests to examine innovative ways of addressing pressing social and economic needs in communities.

The group also seeks to enhance social entrepreneurs' leadership and management skills while conducting research designed to advance knowledge about social entrepreneurship.

He adds Alberta likely ranks No. 1 in the marketization race because most of the new companies are linked to the oil and gas industry.

Indeed, the UBC study found oil and gas companies receive the bulk of venture capital in Alberta, while information technology and biotech firms take the most in B.C. and manufacturers receive the majority in Ontario.

McPherson says Alberta's social entrepreneurs are just starting to seek venture capital. Until now, they have sought financial help from granting agencies, philanthropists and other sources.

"(Social entrepreneurs) have a larger mission than making money, and they don't have that making-profit mentality, so they have to learn that and acquire it," says McPherson. "So they're going to go where they think the money is - but that doesn't necessarily mean venture capital."
According to various reports, oil and gas financing offers sell out quickly but Alberta companies in other sectors have to fight for every dollar they can get. Commodity prices are at record levels and the producers receive royalty rebates of up to $100,000 per well from the provincial government. But Premier Ralph Klein's Tory government does not offer a venture-capital incentive similar to the B.C. program.

Overall, Canada brought companies to market sooner than the U.S., in an average of 76 months versus 85 months.
Canadian venture capital-backed companies generated a total exit value of only $30 billion US, while 3,047 American firms generated $381 billion US. Hellman says comparisons of the amounts invested are "superficial" given the sizes of the two countries.

"Relative to the amount of dollars spent on R&D, we're actually creating more value than our friends south of the border," says Hellman.

Canada's exit values were three per cent higher than American exit values per gross domestic product and 15 per cent higher per dollar of venture-capital investment.

The findings are aimed at governments, Canadian and American venture capitalists, and others who invest in research and development projects. Hellman believes the results could attract American investors from outside Silicon Valley, whose investors focus on their own region. He says venture capitalists must look beyond the amount of money invested and consider successes from both IPOs and acquisitions, while comparing exit values with the amount of money invested and R&D expenditures.

Basil Peters, manager of the BC Tech Fund, which provides startup capital to early-stage technology companies, calls the study "a great piece of work," but he's not surprised by the findings.

"What it really points to is called a velocity of investment," says Peters, who oversees $5 million in venture capital as part of the $30-million BC Advantage Funds that he co-founded in 2003.

Agreeing the TSX Venture exchange has accelerated marketization, he likens technology and life-sciences companies to early-stage mining companies that were once the base of the Vancouver Stock Exchange, from which the TSX Venture evolved. He says the TSX Venture gives investors a way to pool their money together.

"It's a funny thing about Vancouver," says Peters, who also founded the Nexus Group of companies. "We're a very entrepreneurial and knowledge-based community, but we can't underestimate the effects of public venture capital money here in Vancouver."

The study, he says, also shows B.C.'s venture capital community is just as good as its American counterparts. A Vancouver native, Peters moved to Silicon Valley several years ago to head up a technology company.

But he moved home because he says he found people here were just as talented and investors knew what they were doing. "The reason we're getting return on investment is because we've got good people here," says Peters.

The UBC study also points to a "funding gap" or "capital gap" in venture capital markets, he says. U.S. venture capitalists are managing much larger funds than they were a decade ago, but they only invest in firms that require $10 million or more, hampering companies that are too small for a $10-million investment but too big for angels and family and friends.
As a result, Peters is in the process of creating a new venture capital fund, Fundamental Technologies II, which will serve companies needing approximately $2-$7 million in financing.

"That funding gap should be called a funding opportunity," says Peters, adding smaller companies generate bigger returns on investment nine times out of 10.

Peters is creating the fund so he can invest in companies in Alberta, the U.S. and elsewhere.
The BC Tech Fund was established to coincide with B.C.'s Small Business Venture Capital Act, which provides B.C. investors who finance B.C. companies with a 30-per- cent refundable tax credit.

David Shore, a partner in Stirling Mercantile Corp., a Vancouver-based investment bank that also provides cash to tech startups, believes B.C. companies may now get to market faster than Alberta firms.

He says B.C.'s venture capital market has "changed dramatically" since the law came into effect. Venture capitalists are much more willing to invest, he adds, than they were around the time of the tech market crash in 2000 and 2001.
Shore believes B.C. firms may actually get to market faster than Hellmann's study indicates.

Simpler investment terms at the earliest financing stage, whereby investors agree to take common shares and then receive preferred shares in later financing rounds, are also getting startups to market earlier than expected for lower legal costs, says Shore.

Tech company financiers and operators are also mentoring seed-stage company owners and helping them avoid mistakes.
Perry Kinkaide, president and CEO of Edmonton-based enrolNet, says more capital should be available for companies in the earliest stages of development - those seeking $50,000 to $500,000.

"Most of the companies I work with would not be applicable to that study," says Kinkaide, adding companies that hold IPOs or are acquired are already more advanced than many startups.

EnrolNet provides online registration services, data management, website management, cash management and event management for community sports associations and other organizations.

Kinkaide describes financing for early-stage companies in one word - "awful."

He says B.C.'s venture-capital rebate program is "very definitely worth looking at in Alberta."

"It's the early stage where the biggest problem is," says Kinkaide. "Too many companies die too early."

(Monte Stewart can be reached at monte@businessedge.ca)

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